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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY TO
IMPLEMENT STEP TWO OF ITS ACRM FOR ITS
PARADISE VALLEY WATER DISTRICTS

DOCKET NOS. W-01303A-05-0405
W-01303A-05-0910

**ARIZONA-AMERICAN WATER COMPANY
RESPONSE TO RUCO'S LETTER TO COMMISSIONERS**

On October 21, 2008, Stephen Ahearn, Director of the Residential Utility Consumer Office ("RUCO") filed a letter to the Commissioners of the Arizona Corporation Commission ("Commission"). The letter expressed RUCO's on-going objection to including additional capital costs in Step Two of a Company's Arsenic Cost Recovery Mechanism ("ACRM"). Arizona-American Water Company ("Arizona-American") hereby responds to RUCO's letter. As discussed below, RUCO's letter misstates the historical record and its recommendation is against settled public policy.

Attached to the letter was an excerpt from Decision No. 66400, purportedly to bolster RUCO's position that additional capital costs cannot be recovered as part of a Step-Two ACRM surcharge. But the Decision does not support RUCO's claim. Decision No. 66400 states: "Staff and RUCO believe that the ACRM should be limited to two steps in order to reduce the number of increases imposed on customers.¹ But at that time "RUCO oppose[d] inclusion of O&M expenses in the ACRM."² The only logical conclusion is that, in 2002-03, RUCO believed that each step of the ACRM would and should include additional capital costs. Otherwise, without

¹ Decision No. 66400, dated October 14, 2003, at 9:3-4 (citations omitted).

² *Id.* at 7:20.

Arizona Corporation Commission

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17 providing recovery of O&M expenses, Step Two would have been superfluous. Decision No.
18 66400 provides no support for RUCO.³

19 RUCO maintains its position is supported by an excerpt cited in Decision No. 68310
20 from Mr. Broderick's testimony concerning the expected Step-Two Filing. Mr. Broderick there
21 stated that Arizona-American would defer recoverable O&M costs and, in a subsequent Step-
22 Two Filing, "could seek recognition of the prior 12 months of deferred O&M costs, as well as
23 ongoing O&M costs" This is a very thin reed on which to hang an argument. First, the
24 ACRM in this case was approved in Decision No. 68858, not in the cited Decision No. 68310.
25 Second, it is correct that Mr. Broderick testified in another case that deferred and ongoing O&M
26 costs would be recovered through a Step-Two Surcharge. However, Mr. Broderick never
27 suggested that remaining capital costs could not be recovered as part of a Step-Two Surcharge.

28 At Open Meeting, RUCO counsel Dan Pozefsky maintained that allowing recovery of
29 additional capital costs in a Step-Two surcharge was against Commission precedent. This was
30 incorrect; the Commission has never previously considered a Step-Two Surcharge application.
31 To Arizona-American's knowledge, this was the first such filing by any company. The
32 Commission was free to and did consider RUCO's position, but ultimately concluded that
33 precedent and public policy supported recovering all ACRM capital costs through the Step
34 surcharges.

35 There will almost always be some capital costs remaining for recovery after a Step-One
36 proceeding. A utility must have made the majority of its plant investment before Staff verifies
37 that the plant is operational – treating water to remove arsenic. However, "operational" does not
38 mean "complete." Some additional construction will normally be required. But to avoid
39 continuing financial harm, the utility needs to file to implement its Step-One Surcharge as

³ In its October 22, 2008, "Comments on Staff Recommendation of Approval of Arsenic Cost Recovery Mechanism Surcharge," RUCO claims (at 2:9) that page 20 of Decision No. 66400 supports its position. Arizona-American has diligently read page 20, along with the rest of the Decision, and can find nothing that supports RUCO's position.

40 quickly as possible. The utility must also begin deferring its O&M costs for recovery in a Step-
41 Two Surcharge.

42 The facts in this case demonstrate why there will almost always be some capital costs
43 included in a Step-Two Filing. As stated above, Arizona-American's ACRM for its Paradise
44 Valley Water District was approved by Decision No. 68858. In Decision No. 69396, the
45 Commission then approved Arizona-American's Step-One ACRM Surcharge to recover
46 approximately \$18.6 million in net ACRM plant investment.⁴ However, this was just the
47 minimum required investment for the plant to begin operating and removing arsenic from local
48 wells.

49 Additional construction was still needed to complete all facilities required by the City of
50 Scottsdale to site the plant in a largely-residential neighborhood. As verified by Staff:

51 During the period of March 2007 to August 2008 the Company completed construction
52 of 1) a stone block fence with security gates at the PV arsenic treatment plant, 2) an on-
53 site storm water drainage system, 3) sound barriers in the blower building, 4) sound
54 barriers in a building which houses the pump station and, 5) sound barriers in a building
55 which houses the sludge press.⁵

56 RUCO does not suggest that construction of these facilities was not needed to satisfy Arizona-
57 American's obligation to reduce arsenic levels from 50 ppb to the new federal standard of 10
58 ppb. RUCO does not claim that the facilities were not completed during the 18-month period
59 following Decision No. 68396. RUCO did not maintain that any of the costs were imprudent.
60 Therefore, these costs were properly approved for recovery through Arizona-American's Step-
61 Two Surcharge.

62 If Arizona-American wanted to recover all ACRM capital costs, RUCO's position in this
63 case would have required the Company to delay its Step-One filing for an additional year. By

⁴ Decision No. 69396, dated March 22, 2007, at 6:4-5.

⁵ Staff Engineering Memorandum, Docket Nos. W-01303A-05-0405 and W-01303A-05-0910, dated August 18, 2008.

64 that time, recovery of deferred and on-going O&M expense would be timely. The result would
65 be to compress the two-step ACRM into one grand filing for all capital and O&M expenses.

66 RUCO would provide Arizona-American and other companies with a difficult choice:
67 either promptly file a Step-One application—and forgo recovery of continuing required
68 construction costs—or delay any filing until all construction is completed and thereby delaying
69 recovery of investment in ACRM plant already in service. This is not what the Commission
70 intended. RUCO's position is not based on the historical record and would be bad public policy.
71 The Commission should reject RUCO's position in this and all future ACRM Step-Two cases.
72 Recovery of remaining ACRM capital investment should be recoverable as part of the ACRM
73 Step-Two surcharge.

74 RESPECTFULLY SUBMITTED on October 24, 2008.

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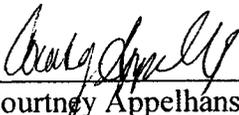
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